

SELECTED PROBLEMS IN VOLUNTARY POOLING: A SUGGESTED RATIONALE

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INTRODUCTION

Town lot drilling in the villages of Edison, Mt. Gilead, and Cardington, Ohio, since 1962, coupled with the issuance of ten-acre minimum spacing regulations,¹ has led to recent widespread use of voluntary pooling devices for oil and gas leases of Ohio lands. Ohio has not yet developed a jurisprudence on the law of voluntary pooling, but its courts have considered and applied implied covenant doctrines. As will be seen, the analogies between implied covenant problems and voluntary pooling problems suggests a rationale to be applied in voluntary pooling cases.

Compulsory pooling will not be considered in this article,² although cases in which pooling was accomplished under the order of a state agency are cited where the manner of pooling is not treated as consequential by the court. Pooling by separate agreement will not be considered, since such agreements usually provide clauses dealing with the problems to be discussed. The pooling³

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¹ Ohio Rev. Code Ann. § 4159.031 (Page 1965) became effective March 10, 1964, as did emergency ten-acre minimum spacing regulations issued by the Chief of the Division of Mines, Ohio Department of Industrial Relations. Final spacing regulations effective May 10, 1964, provided in Rule IV(C)

(1) No permit shall be issued to drill, deepen, reopen, or plug back a well for the production of oil or gas unless the proposed well is located

(a) upon a tract or drilling unit containing not less than 10 acres;

(b) not less than 460 feet from any well drilling to, producing from, or capable of producing from, the same pool;

(c) not less than 230 feet from a boundary of the subject tract or drilling unit.

The validity of these regulations has not been tested.

² Mandatory pooling of tracts having less than ten acres or the prescribed minimum distances with sufficient adjacent acreage to permit a single well location can result from application by the person having the right to drill under Rule IV(D) (2), issued April 28, 1964, by the Chief of the Division of Mines, Ohio Department of Industrial Relations.

³ Although pooling frequently refers to one-well units and unitization usually refers to larger or more comprehensive units, these terms will be treated herein as synonymous.

devices principally treated here are the community lease and the pooling clause.

Stated in simplest form, the problems considered in connection with community leases arise where *A* and *B* each separately own adjoining tracts of land and execute one lease to *C* describing both tracts. In the pooling clause situation *A* and *B* each execute separate leases to *C* in which *C* is expressly given the right at some future time to pool or combine their lands. If *A*, *B*, and *C* expressly provide details concerning the pooling of their lands, the lease provisions will be enforced. Litigation has arisen principally where specific provisions do not cover the question in issue. In such situations the courts must imply rules or standards to determine the relationship among *A*, *B*, and *C*. Unfortunately, the courts have not considered whether these implications are implications of law or fact.

I. THE COMMUNITY LEASE

A community lease is brought about where two or more owners of separate tracts of land execute a single lease describing their entire acreage.⁴ As used herein, community leases include only such leases as achieve pooling upon execution, but not leases containing a provision permitting the inclusion of additional parcels within the leased area by the lessee at some future time. Future pooling is considered later under sections on pooling clauses.

Relationship Between Lessors: Apportionment

Problems concerning community leases usually involve the relationship between the lessors and not between the lessors collectively and the lessee. The rights of the lessee under a community lease are indivisible because the lessee has specifically bargained for the right to treat all included tracts as an entirety in order to perpetuate and develop the lease and to avoid any necessity for respecting internal boundary lines.⁵

⁴ Williams & Meyers, *Oil and Gas Terms* 39 (1957), define a community lease as

a single lease covering two or more separately owned tracts of land. A community lease may arise from the execution of a single lease by the several owners of separate tracts or by the execution of separate but identical leases by the owners of separate tracts individually when each lease purports to cover the entire consolidated acreage.

⁵ *Higgins v. California Petroleum & Asphalt Co.*, 109 Cal. 304, 41 Pac. 1087 (1895); *Parker v. Parker*, 144 S.W.2d 303 (Tex. Civ. App. 1940); *Lynch v. Davis*, 79 W. Va. 437, 92 S.E. 427 (1917).

The fundamental community leases question is whether royalties must be apportioned among all lessors or whether royalties will be paid only to the owner of the tract from which production is obtained. As will be seen from the cases that follow, the courts frequently are faced with a lease containing no specific language dealing with the question and, therefore, must imply or refuse to imply the apportionment result.⁶

The courts which have considered community leases have not adopted a common rationale to justify their implication of royalty apportionment. The early decisions recognized that since the lessee's rights are indivisible, the lessee could drill upon one included parcel while holding all other included parcels without any payment of royalties or rentals to the other community lessors if royalties were not apportioned. In addition to this equitable consideration, the courts also noted that the community lease usually provides for payment of royalties to the lessor without a specific provision requiring payment to the owner of the land from which production is obtained.⁷ *Higgins v. California Petroleum & Asphalt Co.*,⁸ was one of the first cases to consider the problem of apportionment in a community lease. In *Higgins*, a twenty year lease of a deposit of bituminous rock and a deposit or liquid asphaltum was executed by the owners of separate, adjacent tracts. The owner of one tract conveyed her entire interest to the lessee and all mining activities occurred on her tract. The other owner sued the lessee for one-half of the royalty, and judgment for plaintiff was affirmed. The court presumed that the royalties were to be divided equally, noting that the lease provided that royalties were to be paid "to the parties of the first part"⁹ and that the lessee was not restricted to mining activities on any particular part of the land.

⁶ In addition to deciding whether to apportion, a court must decide how to apportion. The court in *Higgins v. California Petroleum & Asphalt Co.*, 109 Cal. 304, 41 Pac. 1087 (1895), suggested a sharing of royalty on the basis of comparative value. This suggestion would necessitate consideration of thickness of pay, porosity, permeability, position on the structure, and many other factors necessary to estimate the amount of oil under each parcel included within the community lease. Absent a lease provision to the contrary, the courts usually apportion royalties on the basis of acreage contributed by each lessor. *Peerless Oil & Gas Co. v. Tipken*, 190 Okla. 396, 124 P.2d 418 (1942); *Parker v. Parker*, *supra* note 5; *Lynch v. Davis*, *supra* note 5. It is submitted that the acreage basis of apportionment is both practical and fair because first, the division of royalties can readily be determined and, second, when the community lease is executed the parties seldom can estimate the amount of oil under each parcel.

⁷ *Higgins v. California Petroleum & Asphalt Co.*, *supra* note 5; *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, 185 La. 751, 170 So. 785 (1936).

⁸ *Supra* note 5.

⁹ *Id.* at 306, 41 Pac. at 1088. (Emphasis added.)

The states which apportion royalties do so either as a matter of law or by an implication of fact. Texas apportions royalties as a matter of law under a community lease¹⁰ and California and West Virginia substantially follow this rule.¹¹ It is my opinion that such a rule fosters stability of leasehold titles and avoids controversy in a situation conducive to fraud, while the implication-of-fact rule which appears in the Oklahoma and Louisiana decisions does not. In Oklahoma, the parol evidence rule has been relaxed and the making of a bare community lease raises a presumption, which may be rebutted by written or oral evidence, of an intention to apportion royalties.¹² In Louisiana the lessor's intent is examined on a case-by-case basis which has led to decisions which are hard to reconcile.¹³

The courts which consider apportionment a question of fact have found neither the lesser interest clause nor the entireties clause, which commonly appear in oil and gas leases, controlling in deciding whether apportionment results from the execution of a community lease. *Peerless Oil & Gas Co. v. Tipken*¹⁴ considered the following lesser interest clause:

If said lessor owns a less interest in the above-described land than the entire and undivided fee-simple estate therein, then the rentals and royalties herein provided for shall be paid the lessor only in the proportion which . . . [the lessor's] interest bears to the whole and undivided fee.¹⁵

While apportionment was found to result from the facts in the case, the court specifically refused to base its decision upon the lesser interest clause. As was pointed out by the dissenting opinion, a lesser interest clause is intended to protect the lessee from paying full royalties to a lessor whose title has failed in whole or in part. The

¹⁰ See *French v. George*, 159 S.W.2d 566 (Tex. Civ. App. 1942); *Parker v. Parker*, *supra* note 5, at 305.

¹¹ See *Higgins v. California Petroleum & Asphalt Co.*, *supra* note 5; *Clark v. Elsinore Oil Co.*, 138 Cal. App. 631 P.2d 476 (1934); *Hamilton v. McCall Drilling Co.*, 131 W. Va. 750, 50 S.E.2d 482 (1948); *Lynch v. Davis*, *supra* note 5.

¹² *Peerless Oil & Gas Co. v. Tipken*, 190 Okla. 396, 124 P.2d 418 (1942). Compare *Seal v. Banes*, 183 Okla. 203, 80 P.2d 657 (1938).

¹³ In *United Gas Pub. Serv. Co. v. Eaton*, 153 So. 702 (La. Ct. App. 1934), the court refused to apportion royalties under a community lease and appeared to condemn the apportionment result. *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, *supra* note 7, approved the apportionment result on the basis of rather common oil and gas lease language. The distinction between the cases is hard to justify and has been criticized. *Hoffman, Voluntary Pooling and Unitization* 44 (1954).

¹⁴ 170 Okla. 396, 124 P.2d 418 (1942).

¹⁵ *Id.* at 397, 124 P.2d at 419.

usual entireties clause of an oil and gas lease is designed to deal with subsequent division of the premises, not with separate ownership at the time the lease is executed,¹⁶ unless the entireties clause specifically contemplates ownership in severalty when the lease is executed.¹⁷

If the lessors execute a lease, where apportionment is implied in law, describing more land than is owned by any of them, apportionment will occur even though the community lease does not specifically name all lessors who are to be parties thereto.¹⁸ Moreover, ratification of the original community lease by an additional owner of lands included therewith has been held to achieve the apportionment-of-royalties result.¹⁹

¹⁶ In *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, *supra* note 7, at 759, 170 So. at 787, parcels approximately three-quarters of a mile apart were included under one lease which contained the following entireties clause:

That, regardless of any such change or division, said land shall be developed and operated, and all royalties accruing hereunder shall be treated, as an entirety; such royalties shall at all times be divided among and paid to the owners thereof in proportions according to the acreage and/or interest owned by each.

The court admitted this clause dealt with future changes in ownership, but was obviously influenced by the apportionment result it required.

¹⁷ See *Hardwicke & Hardwicke*, "Apportionment of Royalty to Separate Tracts: the Entireties Clause and the Community Lease," 32 *Texas L. Rev.* 660 (1954), for a thorough discussion of this point.

¹⁸ *Irick v. Hubbell & Webb*, 280 P.2d 733 (Okla. 1955). The court said: The fact that here, instead of all owners signing one lease, all owners signed separate identical instruments makes no difference. As in the *Peerless* case . . . the signing of the instruments covering the entire tract bespoke an intention on the part of each lessor that the tract would be developed as a unit.

Id. at 735.

Hoffman has criticized the *Irick* case on the ground that the decision might require the apportionment of royalties where lessor *A* innocently describes land he does not own and lessor *B*, by a separate instrument, later describes the same lands which are in fact owned by *B*. Hoffman, "Some Problems in Pooling and Unitization," *Seventh Annual Institute on Oil and Gas Law and Taxation* 219, 227-30 (1956). I cannot agree with Hoffman's criticism because, where additional properties are innocently included in a separate lease, mutual mistake may justify reformation of the instrument. In *Harris v. Wood County Cotton Oil Co.*, 222 S.W.2d 331 (Tex. Civ. App. 1949), the defendant believed he owned lot 12 and the western half of lot 11 and leased both, although plaintiff in fact owned the western half of lot 11. The lessee obtained a permit from the Texas Railroad Commission and drilled a producing well on lot 12. The plaintiff contended that these facts required an apportionment of royalties. The court held for the defendant, commenting that the controlling element was the intention to pool and unitize, which was lacking in this case. *Accord*, *Seal v. Banes*, *supra* note 12.

¹⁹ *Louisiana Canal Co. v. Heyd*, 189 La. 903, 181 So. 439 (1938) (ratification by acceptance of delay rentals). In *Ward v. Gohlke*, 279 S.W.2d 422 (Tex. Civ. App. 1955), undivided-interest owners in four tracts (some of whom did not own interests

It has been held that apportionment of royalties will not be implied where nonadjacent parcels are included under one community lease.²⁰ If apportionment is implied in law where separate owners execute one lease describing all properties, it is difficult to justify a distinction between abutting and nonabutting properties.²¹

While a majority of the courts have approved the apportionment of royalties where two or more owners of separate tracts execute one lease, the contrary result has obtained where part of a single parcel under lease is later divided in ownership. The Ohio Supreme Court in the landmark case of *Northwestern Ohio Natural Gas Co. v. Ullery*²² refused to apportion royalties when faced with a subdivision of lands subject to an oil and gas lease. It is now well settled that the fact that a subdivision of land subject to a lease will not achieve apportionment does not prevent the court from apportioning royalties under a community lease.²³ Apportionment under a community lease where separate ownership of the lands exists prior to the lease, but nonapportionment where separate ownership occurs subsequent to the lease, is difficult to rationalize.²⁴

in all tracts) executed one lease describing all four tracts and identifying the parties lessor as "the undersigned heirs and devisees under the will of Fred W. Gohlke." *Id.* at 425. Three other undivided-interest owners ratified the lease and one interest owner executed a separate lease. The court held pooling occurred as to all who eventually became lessors.

²⁰ *Lusk v. Green*, 114 Okla. 113, 245 Pac. 636 (1926). The court was apparently influenced by parol evidence.

²¹ *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, *supra* note 7, apportioned royalties on an acreage basis despite the inclusion under one lease of two parcels approximately three-quarters of a mile apart.

²² 68 Ohio St. 259, 67 N.E. 494 (1903).

²³ *Jephat v. McRae*, 276 S.W. 669 (Tex. Comm'n App. 1925), cited and followed the *Ullery* case. *Parker v. Parker*, *supra* note 5, held that the *Japhat* rule did not apply to a community lease and allocated royalties on an acreage basis. *Galt v. Metscher*, 103 Okla. 271, 229 Pac. 522 (1923), established the *Japhat-Ullery* rule in Oklahoma under peculiar facts. One hundred and sixty acres were under lease and the royalty in the south eighty acres was conveyed. The lessee attempted to drill on the exact line but missed by four feet and the court held that all royalty went to the owner of the tract on which the well was drilled with no liability to the other owner to drill an offset. (Query the bottom hole location.) In *Peerless Oil & Gas Co. v. Tipken*, *supra* note 12, the court admitted the nonapportionment rule applied to conveyances of separate parcels after the lease is executed but held that apportionment of royalties occurred under a community lease.

²⁴ *Lynch v. Davis*, *supra* note 5, did not recognize the distinction based upon division of ownership of the land prior and subsequent to the lease. The court apportioned royalties under a community lease but relied upon and cited the minority view in *Wettengel v. Gormley*, 160 Pa. 559, 28 Atl. 934 (1894), on second appeal, 184 Pa. 354, 39 Atl. 57 (1898), involving a division of the land after execution of the lease. Writers on the subject have pointed to the inconsistency of refusing to apportion royalties in the *Ullery* situation while apportioning royalties in the community

Relationship Between Lessors: Real Property Concepts v. Contract Concepts

The *Higgins* court held that adjoining owners shared equally in royalties without analyzing the relationship between the lessors further than to point out that they did not become tenants in common. Subsequent California decisions have ignored the language in *Higgins* disclaiming a tenancy-in-common result and have held that execution of a community lease achieves a cross conveyance of royalty interests.²⁵ Texas cases appear to follow the California cross-conveyancing theory,²⁶ although recent Texas decisions²⁷ cast some doubt upon the continuing validity of that rule, particularly as applied to specific pooling clauses. The better analysis would seem to be that the lessors by executing one lease describing their entire lands impliedly agree *inter se* that royalties under the lease will be shared in proportion to the acreage contributed by each.²⁸ This contract analysis finds support in the absence of words of conveyance or grant between the lessors in the ordinary community lease.

Avoidance of real-property concepts and utilization of contract concepts should help to avoid difficulties the courts have experienced in connection with partial surrender and conveyances of separate tracts included in a community lease. A series of California decisions has held that a partial surrender by the lessee does not extinguish the right of the lessor of the surrendered acreage to continue to participate in apportioned royalties, but denies to the owners of the retained acreage the comparable right to participate in subsequent

lease situation. See Hoffman, Voluntary Pooling and Unitization 18 (1954); O'Quin, "Separately Owned Tracts Under Single Lease as Affected by Entirety Clause and Related Provisions," Eighth Annual Institute on Oil and Gas Law and Taxation 125 (1957).

²⁵ *Tanner v. Title Ins. & Trust Co.*, 20 Cal. 2d 814, 129 P.2d 383 (1942); *Agajanian v. Cuccio*, 141 Cal. App. 2d 828, 297 P.2d 755 (1956).

²⁶ *Veal v. Thomason*, 138 Tex. 314, 159 S.W.2d 472 (1942). Although *Veal v. Thomason* is frequently cited as Texas authority for the cross-conveyancing theory, the court there placed emphasis upon specific clauses of the lease providing for the sharing of royalties and construed these clauses to reflect an intention to achieve a cross conveyance of royalty interests.

²⁷ *Tiller v. Fields*, 301 S.W.2d 185 (Tex. Civ. App. 1957); *Sohio Petroleum Co. v. Jurek*, 248 S.W.2d 294 (Tex. Civ. App. 1952).

²⁸ The cross-conveyance theory has been rejected in several jurisdictions. *Phillips Petroleum Co. v. Peterson*, 218 F.2d (10th Cir. 1954) (pooling clause case); *Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co.*, *supra* note 7; *Sinclair Crude Oil Co. v. Oklahoma Tax Comm'n*, 326 P.2d 1051 (Okla. 1958) (pooling clause case). A leading authority on the subject has also criticized the cross-conveyance theory. Hoffman, Voluntary Pooling and Unitization 102-03 (1954).

production obtained under a new lease of the surrendered acreage.²⁹ In Texas the cross-conveyancing theory has received support, but the result reached in the California cases has not been followed. In *Duffy v. Callaway*³⁰ the court held that a partial surrender recasts the acreage allocation in relationship to the acreage retained after partial surrender. Presumably in Texas if all of *A*'s lands were surrendered by the lessee, *A* would no longer participate in production under the community lease. The result is practical and probably would reflect the intention of the parties had they considered the question, but casts additional doubt upon the continuing vitality of the cross-conveyancing theory in that state.

Adoption of the cross-conveyancing theory can multiply title problems by splintering royalty interests. The problem is aggravated where a conveyance of a specific tract included within a community lease is made without reference to participation in the royalty allocated under the entire lease. Under the cross-conveyance theory, the grantor may be found to have retained his allocated royalty participation in the remaining parcels despite having purported to convey his entire interest in his separate parcel.³¹ Under the contract theory, a conveyance of the lessor's separate parcel without spe-

²⁹ The first California case to consider the effect of a partial surrender was *Clark v. Elsinore Oil Co.*, 138 Cal. App. 6, 31 P.2d 476 (1934), in which *A* and *B*, each owning adjoining forty acre tracts, executed one lease. The lease contained both a royalty-apportionment provision and a surrender provision which was silent with respect to the effect of surrender on royalty payments. The lessee surrendered seventy acres and retained only ten acres on which he had drilled a well. The court held that the plaintiff whose lands had been entirely surrendered continued to be entitled to one-half of the royalties, citing the *Higgins* case. The court did not mention the cross-conveyancing theory which would have provided a logical basis for the result. In the well known case of *Tanner v. Title Ins. & Trust Co.*, 20 Cal. 2d 814, 129 P.2d 383 (1942), nine lots were included under a community lease. The lessee drilled on lots 174 and 176 and surrendered the balance. The owners of lots 174 and 176 sued to quiet title and to prevent the surrendered-lot owners from participating in royalties. A specific clause provided, "this provision as to apportionment of benefits to be operative, notwithstanding the surrender by the Lessee of any land described herein," and the court held apportionment of royalties from the two producing lots survived partial surrender, despite a 1937 quiet title judgment with respect to the surrendered lots. In *Tanner v. Olds*, 29 Cal. 2d 110, 173 P.2d 6 (1946), the owners of one of the lots which had earlier been surrendered and had later leased their lot and obtained production. The question on appeal was whether drainage of oil from lots 174 and 176 by the newly productive well on the lot which had earlier been surrendered furnished sufficient grounds for a forfeiture of the surrendered-lot owner's right to receive apportioned royalty from lots 174 and 176. The court was faced with the earlier 1937 quiet title judgment which was no longer subject to appeal, and held that participation in royalties from lots 174 and 176 did not cease.

³⁰ 309 S.W.2d 853 (Tex. Civ. App. 1958).

³¹ *Agajanian v. Cuccio*, 141 Cal. App. 2d 828, 297 P.2d 755 (1956), held that a bare conveyance of land did not include the lessor's community-lease royalty interests.

cific mention of the lessor's royalties under the community leasehold will normally convey the lessor's entire interest in both his tract and apportioned royalties.³² In Texas partition has been held to terminate apportionment of royalties where all lessors join in the proceedings.³³ Although the action of the lessors cannot free any part of the lease from the right of the lessee to develop and operate the entire premises as an entirety, unpooling by the lessors of a portion of the premises may increase the burden of the lessee, if oil is obtained on the portion severed from the pool, by requiring separate tankage, metering, and accounting.³⁴ It is submitted that a fair result would be obtained if the courts permitted the operator to deduct from royalty payments the additional cost of separate tankage, or metering facilities and separate accounting.

POOLING CLAUSES

With increasing frequency, modern oil and gas leases contain a pooling clause under which the lessee is granted authority at some future time to pool the premises under lease with other premises.³⁵

The same result was indicated in *Tanner v. Title Ins. & Trust Co.*, *supra* note 29, where the court said:

The royalty interest thus transferred by each landowner to his colessors is an incorporeal hereditament in gross . . . and the grantee's interest in the oil produced upon the property of one of the colessors is entirely separate and distinct from royalty interest retained by him in oil which might be produced from his own premises. . . .

The incorporeal hereditament owned by the grantor in the oil produced from the land of the colessors, existing in gross, obviously does not follow the conveyance of the lessor's land, but can only be conveyed by a specific transfer of that interest.

Id. at 820, 129 P.2d at 386-87. The cases do not clearly indicate whether the cross-conveyance theory means all royalty is thrown into hotchpot or whether each lessor reserves his own allocated portion of royalty and conveys only the balance. The quotation from *Tanner* seems to suggest the latter.

³² *Merrill Eng'r Co. v. Capital Nat'l Bank*, 192 Miss. 378, 5 So. 2d 666 (1942). The *Merrill* case involved a separate pooling agreement, but the court specifically rejected any distinction based upon this fact. The court said that rights to unit royalties passed as covenants running with the land.

³³ *Garza v. DeMontalvo*, 147 Tex. 525, 217 S.W.2d 988 (1949). In *Landgrebe v. Rock Hill Oil Co.*, 273 S.W.2d 636 (Tex. Civ. App. 1954), a partition of two of the three tracts originally included under a community lease was found not to unpool the third tract.

³⁴ The court in *Garza v. DeMontalvo*, *supra* note 33, specifically pointed out that the lessee had raised no objection to the partition. The decision suggests that the Texas courts may protect the lessee from increased burdens resulting from any change from allocated to separate royalty payments.

³⁵ *Williams & Meyers, Oil and Gas Terms* 185 (1957), define a pooling clause as a lease clause authorizing a lessee to "pool" or join the particular leased

Although these clauses vary between detailed clauses setting forth the manner and many of the results of such pooling to short clauses giving broad authority to affect such pooling,³⁶ the lessee by express provision or by implication is usually granted the power to treat the entire premises as one lease; and the lessor usually agrees to accept royalties under his lease upon that part of production which is apportioned to his lease.³⁷ Unlike community leases, pooling does not occur upon execution of the lease but only at some future time when the lessee undertakes a pooling effort. Emphasis in pooling questions thus is shifted from the lessor-lessee relationship to the lessee-lessor relationship.

Lessee-Lessor Relationship: Real Property Concepts v. Contract Concepts

Legal writers have devoted considerable attention to the relationship between the lessor and lessee resulting from the exercise of rights granted in the pooling clause.³⁸ Unfortunately, real-property concepts were applied at an early date to this relationship. Texas and California have both indicated that pooling effects a cross conveyance of royalty interests, but these cases principally concerned community leases, not pooling achieved by the exercise of a power granted in a pooling clause.³⁹ The trend of authority is against the

premises with other leases for the purpose of aggregating a tract sufficient for a well permit under applicable spacing regulations. Also, a lease clause authorizing the lessee to unitize the leased premises with other parcels.

This author does not entirely agree with the definition suggested by Williams and Meyers, because pooling does not necessarily have any relationship to spacing, nor need broad unitization be contemplated in a pooling clause.

³⁶ See 4 Williams, Oil and Gas Law § 669 (1964), citing numerous pooling clauses.

³⁷ The right to develop, produce, and operate the entire pooled lands without regard to internal boundary lines is that for which the lessee specifically bargains in the pooling clause. *E.g.*, in *Hunter Co. v. Shell Oil Co.*, 211 La. 893, 902, 31 So. 2d 10, 13 (1947), the court said, "The law is well settled that the lessee's obligation to drill a well is indivisible in its nature. . . ."

³⁸ *E.g.*, Hardwicke, "Problems Arising Out of Royalty Clauses in Oil and Gas Leases in Texas," 29 Texas L. Rev. 790 (1951); Hoffman, "Pooling and Unitization Clauses in Oil Leases," 1 Rocky Mountain Mineral Law Institute 103 (1955); Hoffman, "Some Problems in Pooling and Unitization," Seventh Annual Institute on Oil and Gas Law and Taxation 219 (1956); Merrill, "Unitization Problems: The Position of the Lessor," 1 Okla. L. Rev. 119 (1948); Shank, "Some Legal Problems Presented by the Pooling Provisions of the Modern Oil and Gas Leases," 23 Texas L. Rev. 150 (1944); Williams & Meyers, "The Effect of Pooling and Unitization Upon Oil and Gas Leases," 45 Calif. L. Rev. 411 (1957).

³⁹ *Tanner v. Title Ins. & Trust Co.*, 20 Cal. 2d 814, 129 P.2d 383 (1942); *Veal v. Thomason*, 138 Tex. 431, 159 S.W.2d 472 (1942).

application of the cross-conveyancing theory.⁴⁰ In *Phillips Petroleum Co. v. Peterson*,⁴¹ the court strongly rejected the cross-conveyance theory. *Sinclair Crude Oil Co. v. Oklahoma Tax Comm'n.*⁴² squarely held that no cross conveyance occurred where separate unit agreements were executed by members of the Cherokee tribe, who enjoyed exemption from Oklahoma production and pro-ration taxes so long as they continued to hold their homestead lands. The court held the exemption applied with respect to the allocated portion of unit oil since no cross conveyance occurred. It does not appear that the application of the cross-conveyance theory can be as forcefully urged with respect to units created under a pooling clause as with community leases, because community leases achieve their legal effect by the direct action of the lessors, while pooling under pooling clauses takes effect, if at all, only upon the future act of the lessee with respect to lands usually not identified when the lease is executed.⁴³

Exercise of the pooling power at some indefinite time after the lease is executed has led some courts to suggest that the relationship between the lessor and lessee is that of principal and agent.⁴⁴ The first case to express the agency theory did so to explain a fiduciary duty. In *Imes v. Globe Oil & Ref. Co.*⁴⁵ the lessee was granted the power by the owners of twenty-one lots in Oklahoma City to include other lots in the same subdivision block, but the lessee attempted to include lots which had been condemned for oil and gas purposes. The court stated that the lessee "was *virtually* the agent of the lessors."⁴⁶ Application of agency concepts suggests that the death of the lessor-principal or an assignment by the lessee might terminate the agency relationship. This result has been avoided by classifying the relationship as a power coupled with an interest.⁴⁷

⁴⁰ *Kenoyer v. Magnolia Petroleum Co.*, 173 Kan. 183, 245 P.2d 176 (1952); *Sohio Petroleum Co. v. Jurek*, 248 S.W.2d 294 (Tex. Civ. App. 1952).

⁴¹ 218 F.2d 926 (10th Cir. 1954).

⁴² 326 P.2d 1051 (Okla. 1958).

⁴³ *Sohio Petroleum Co. v. Jurek*, *supra* note 40, distinguished *Veal v. Thomason*, *supra* note 39, on the ground that joint ownership, *i.e.*, cross-conveyancing occurred only under a community lease.

⁴⁴ *E.g.*, *Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954).

⁴⁵ 184 Okla. 79, 84 P.2d 1106 (1938).

⁴⁶ *Id.* at 81, 84 P.2d at 1109. (Emphasis added.)

⁴⁷ In *Phillips Petroleum Co. v. Peterson*, *supra* note 44, the court stated that the relationship between the lessor and the lessee was "at least, analogous to that of principal and agent. It is in the nature of a power coupled with an interest, and is, therefore, irrevocable." *Id.* at 933. The power-coupled-with-an-interest theory had earlier been suggested by a commentator on the subject. Hardwicke, *supra* note 38, at 812.

Perhaps the greatest conceptual difficulty in the application of agency concepts arises with respect to the fiduciary duty. As an agent the lessee should have a fiduciary responsibility to his lessor under which self-dealing would be proscribed. Logically the lessee might be permitted to pool only with a lease of a stranger unless full disclosure were made to the lessor-principal. *Phillips Petroleum Co. v. Peterson*,⁴⁸ a leading case, considered this fiduciary relationship and in so doing raised questions which offer little comfort to lessees. The court noted that an agent of the lessee had met with the lessors prior to execution of the leases, circulated lease forms, specifically explained the pooling clause, and apparently revealed enough of the lessee's plans to satisfy the court that a full disclosure occurred. The court imposed a stringent standard of disclosure upon the lessee when it said: "It is equally well settled that an agent may act with respect to matters involving interests adverse to his principal *where the principal possesses full knowledge of the facts and consents thereto.*"⁴⁹ Does this mean that the lessee who initially has no specific plans to pool must return to his lessor immediately prior to pooling to disclose fully? What if the lessor then strongly objects?

Application of property concepts also has led to unsuccessful efforts to attack pooling clauses as a violation of the Rule Against Perpetuities.⁵⁰ It is submitted that the correct analysis of the relationship between the lessor and lessee is that it is that of contracting parties. Hoffman has so concluded; consequently he defines a pooling clause as

a declaration and agreement by the lessor that the lessee may at a future date operate the lessor's property in conjunction with other properties, in which event production on another property will perpetuate the lessor's lease and provide the measure of the lessor's royalty by the method of allocating a proportionate part of such production to his lease.⁵¹

⁴⁸ 218 F.2d 926 (10th Cir. 1954).

⁴⁹ *Id.* at 934. (Emphasis added.)

⁵⁰ *Phillips Petroleum Co. v. Peterson*, *supra* note 48, is the leading case rejecting the perpetuities argument. The court rejected the cross-conveyance theory, but stated that even if the cross-conveyance theory were applied, a failure to specify when pooling could occur would be taken to imply pooling within a reasonable time, certainly within the period permitted under the Rule Against Perpetuities. The *Imes* case, *supra* note 45, construed a specific authorization to pool at any time to mean only within a reasonable time. See *Kenoyer v. Magnolia Petroleum Co.*, which also held the Rule Against Perpetuities not to be violated by a pooling clause, but stated that under the pooling clause all rights were fixed and vested when the lease was executed and no future estates were created.

⁵¹ Hoffman, *Voluntary Pooling and Unitization* 100 (1954). See *Kenoyer v. Magnolia Petroleum Co.*, *supra* note 40 (contract theory).

Consistent with the contract theory is the rule that the exercise of the pooling authority granted by the lease does not alter other express provisions of the lease.⁵² For instance, royalties will be paid on the same stated fraction set forth in the lease but applied to that part of total unit production allocated to the lease under the unit.⁵³ However, a lease containing a pooling clause will ipso facto terminate if delay rentals are not paid, drilling commenced, or production obtained either on the lease or on the pooled unit within the time specified.

Judicial Limitation of the Lessee's Pooling Power

Inasmuch as the pooling clause deals with future pooling, it is seldom possible to avoid a lack of certainty. The court in *Phillips Petroleum Co. v. Peterson*⁵⁴ upheld an extremely broad pooling clause which contemplated field-wide unitization and gave the lessee authority to "unitize, pool, or combine all or any part of above described lands with other lands in same general area" In response to assertions that the clause was too broad and uncertain to be enforceable, the court said:

Anticipatory provisions in leases for the commitment by the lessee of such leases to unitization, of necessity must be in general terms. Neither the lessor nor the lessee has any way of knowing at the time the lease is taken the facts with respect to which it will be necessary for the lessee to apply his power. It is not practicable for the lessee to await the ascertainment of such facts. He knows from experience that because of the possibility of many changes in ownership of the lessor's interest as time goes on, it may be difficult to effect an agreement for unitization after the lease is taken, if the right to unitize is not included in the lease itself.⁵⁵

⁵² *York v. Harper*, 91 So. 2d 423 (La. Ct. App. 1956).

⁵³ In *Dillon v. Holcomb*, 110 F.2d 610 (5th Cir. 1940), the lease on one of two pooled tracts provided for a one-eighth royalty interest, a sliding-scale override, and an oil payment of \$7,500 to the lessor. The court held that these payments must be made to the lessor out of production allocated to that lease. Thus the allocation was strictly on an acreage basis, but one lessor, pursuant to his lease, received a far larger percentage of that allocation than did the other lessor. The same reasoning was applied in *Arkansas-Louisiana Gas Co. v. Southwest Natural Prod. Co.*, 221 La. 608, 60 So. 2d 9 (1952).

⁵⁴ *Supra* note 48.

⁵⁵ *Id.* at 933. In *Tiller v. Fields*, 301 S.W.2d 185 (Tex. Civ. App. 1957), the court approved a pooling clause which authorized pooling with other lands "in the immediate vicinity," notwithstanding the lack of any acreage limitation.

Since frequently the pooling power is not carefully defined, the courts have implied standards to limit the pooling powers of the lessee. These standards are closely analogous to the standards under implied covenant doctrines. The most widely accepted standard is the so-called "good faith test"⁵⁶ which frequently becomes a subjective good faith test. It is the opinion of this writer that the proper standard is an objective, prudent operator test analogous to the test seen in implied covenant cases. In *Imes v. Globe Oil & Ref. Co.*⁵⁷ the court refused to permit the lessee, after obtaining production on the lots originally included in the lease, to include six additional lots which had been condemned as valueless for oil and gas purposes. The language of the opinion suggests an examination of the lessee's subjective intent although the pooling of condemned oil and gas properties with producing properties could hardly qualify as conduct of a prudent operator. In *Phillips Petroleum Company v. Peterson*,⁵⁸ the court supported an objective test of the lessee's conduct when it said:

A lessee is bound by implied covenants in the lease to diligently explore and develop the lease, and to do so under a fair unitization plan, if unitization is effected; to market the production if the oil and gas is found in paying quantities; to do that which an operator of ordinary prudence, having due regard for the interests of both the lessor and the lessee, would do (cited cases omitted); and in case of unitization, to act fairly and in good faith, with due regard for the lessor's interests, and to provide for a fair apportionment of the oil produced (cited cases omitted). The lessee clearly may not act arbitrarily or capriciously (cited cases omitted).⁵⁹

Several months earlier, the same court in *Boone v. Kerr-McGee Oil Indus.*⁶⁰ approved a trial court's finding that additional wells would

⁵⁶ *Imes v. Globe Oil & Ref. Co.*, *supra* note 45, at 81, 84 P.2d at 1109, noted that while the interest of the lessee and lessors were to some extent mutual at the time the lease was executed, these interests parted somewhat when pooling was attempted and therefore the lessee "was bound to use good faith."

⁵⁷ *Supra* note 45.

⁵⁸ *Supra* note 48.

⁵⁹ *Supra* note 48, at 934.

⁶⁰ 217 F.2d 63 (10th Cir. 1954).

⁶¹ *Harris v. Ohio Oil Co.*, 57 Ohio St. 118, 48, N.E. 502 (1897), is the leading Ohio case. See *Ohio Fuel Supply Co. v. Schilling*, 101 Ohio St. 106, 127 N.E. 873 (1920); *Kachelmacher v. Laird*, 92 Ohio St. 324, 110 N.E. 933 (1915); *Coffinberry v. Sun Oil Co.*, 68 Ohio St. 488, 67 N.E. 1069 (1903); *Tedrowe v. Shaffer*, 23 Ohio App. 343, 155 N.E. 510 (1926).

⁶² *Sauder v. Mid-Continental Petroleum Corp.*, 292 U.S. 272, 279 (1934).

have been wasteful, would have yielded no greater ultimate recovery of oil and gas, and would have resulted in a financial loss to the driller, all of which suggests an objective good faith test.

If the proper standard is whether the lessee complies with the prudent operator test when pooling is undertaken, it is submitted that the questions for determination will be whether the pooling would have been undertaken in nearly the same manner, at approximately the same time, by an ordinary prudent operator who, based upon information available at the time of exercise of the pooling power, is reasonably attempting to ensure that each lessor receives royalties reflecting the amount of oil and gas under his land by a pooling plan which is economically feasible to the lessee. A subjective test of the lessee's intention when exercising the pooling power would reward ignorance and protect unskilled operators.

Ohio, lacking a jurisprudence on pooling questions, but having a substantial jurisprudence on the law of implied covenants,⁶¹ may find by analogy a useful rationale to be applied to future pooling questions. Implied covenant doctrines are fictions implied "from the relation of the parties and the objective of the lease . . ." ⁶² In the lessor-lessee relationship the lessor normally reposes a substantial trust and confidence in the lessee to drill an exploratory well, develop the premises, diligently operate, market the product, and protect the premises against drainage. So also under a broad pooling clause does the lessor trust the lessee to utilize the pooling power to insure that the lessor will receive his fair share of royalties. The receipt of royalties from oil and gas is the principal objective of the lessor. This objective constitutes the foundation of implied covenant doctrines and should also justify restrictions upon the lessee's pooling power. The implication of restrictions upon the lessee's pooling power is therefore properly an implication, not of fact, but of law, arising out of the relationship of the parties and the objective of the lease.

Where an oil and gas lease does not specify when an exploratory well must be drilled, the courts have implied a covenant that the lessee will drill within a reasonable time.⁶³ The reasonable time rule has also been applied to determine when the lessee may effectuate pooling,⁶⁴ and raises questions which might have been, but usually were not, answered by application of the prudent-operator test. The courts have carefully considered whether pooling can be undertaken before or after production is obtained on the unit, and whether

⁶³ Harris v. Ohio Oil Co., *supra* note 61.

⁶⁴ Thomas v. Ley, 177 Okla. 150, 57 P.2d 1186 (1936); Imes v. Globe Oil & Ref. Co., *supra* note 45; Phillips Petroleum Co. v. Peterson, *supra* note 44.

pooling immediately prior is valid.⁶⁵ Pooling after production and pooling immediately prior to the expiration of the primary term both readily suggest a plan designed solely for perpetuating leases. However, these facts should not foreclose a tardy lessor from pooling if the pooling plan meets the prudent-operator standard and only incidentally and permissibly minimizes unnecessary delay rentals and drilling costs. The Oklahoma court in *Imes v. Globe Oil & Ref. Co.* appeared to suggest that once production was obtained no pooling could be undertaken. However, the *Imes* decision was subsequently clarified by *Gillham v. Jenkins*⁶⁶ which upheld pooling after production was obtained. The peculiar fact situation in *Gillham* was that wartime regulations prohibited gas production on less than 160 acres, but the original well was drilled on eighty acres and could not be produced without pooling. However, the *Gillham* court construed *Imes* to be a good faith case and not a ruling against pooling after production.

The Louisiana courts have tightly construed pooling clauses to limit the lessee's power in situations which do not meet the standards of an ordinary prudent operator. In *Wilcox v. Shell Oil Co.*⁶⁷ only twenty acres of a 550 acre lease were pooled with an adjacent twenty acres on which production had already been obtained. The court applied a subjective good faith test which led it to accuse the defendant of avoiding the alternatives of either drilling or paying delay rental. The court said the pooling was "very much to its interest because by it Shell could save a rental payment of \$2,750.00 and at the same time avoid the expense of drilling a well on the Wilcox lease within the 12 months remaining of the primary term in an effort to keep it alive beyond that term."⁶⁸ While the circumstances may have indicated conduct which satisfied neither the good faith test nor the ordinary-prudent-operator test, it is submitted that the avoidance of delay rentals and the expense of drilling unnecessary wells is that for which the lessee bargains when a pooling clause is inserted in an oil and gas lease. In *Mallett v. Union Oil & Gas Corp.*,⁶⁹ the Louisiana court again tightly construed a pooling clause to reach a result which could have been obtained by application of the prudent operator test to the pooling effort. In *Mallett*, a 160 acre lease was assigned to the defendant after the assignor had unsuccessfully sought an extension on the lease only six

⁶⁵ *E.g.*, *Tiller v. Fields*, *supra* note 27. See Note, "The Right of the Lessee to Pool the Mineral Interest of the Lessor Before and After the Expiration of the Primary Term," 10 Sw. L.J. 165 (1956).

⁶⁶ 206 Okla. 440, 244 P.2d 291 (1952).

⁶⁷ 226 La. 417, 76 So. 2d 416 (1954).

⁶⁸ *Id.* at 423, 76 So. 2d at 418.

⁶⁹ 232 La. 157, 94 So. 2d 16 (1957).

weeks prior to the expiration of the primary term. The assignee-defendant filed a declaration of unitization three days prior to the expiration of the primary term and pooled 53.3 acres of the lease with another lease on which production had been obtained three months earlier. This conduct might not meet the prudent operator standard. *Diggs v. Cities Serv. Oil Co.*⁷⁰ specifically referred to the subjective intent of defendants who had attempted pooling, but the court did not criticize the trial court's consideration of geological and other technical facts and opinions. Despite a suggestion to the contrary by one writer,⁷¹ the validity of efforts to utilize a pooling clause should not be tested by conservation principles because a pooling clause creates no more than a contractual relationship between a limited number of private individuals.

Where *A* and *B* each grant leases of 500 acres to *C*, *C* may desire to pool only fifty acres from each lease into a unit. One decision⁷² has upheld partial pooling accomplished under a general pooling clause with no specific authority for partial pooling. Although leading writers on the subject have contended that a partial pooling effects a division of the lessee's obligations under the lease,⁷³ the majority view in the United States is to the contrary. Consequently, delay rentals need not be paid on excluded acreage and the lease does not expire at the end of the primary term with respect to excluded acreage after unit production is obtained.⁷⁴ The majority view is justified because the lessee bargains for the right to treat the lease as an entirety. Implied covenant doctrines are now frequently applied to protect the lessor's interests in excluded acreage and to

⁷⁰ 24 F.2d 425 (10th Cir. 1957).

⁷¹ Long, "The Pooling Clause in an Oil and Gas Lease," 11 Okla. L. Rev. 1 (1958). In *Boone v. Kerr-McGee Oil Indus.*, *supra* note 60, at 64, the pooling clause gave the lessee the option to pool "when in Lessee's judgment it is necessary or advisable to do so in order to properly develop and operate said lease premises so as to promote the conservation of oil, gas or other minerals. . . ." The court did not interject a new principle to be applied with respect to pooling clauses but merely construed the express language of the pooling clause. To interject the public interest and the term "conservation" into every judicial examination of pooling clauses would ignore the obvious intention of the parties where the word "conservation" does not appear in the pooling clause itself.

⁷² *Kenoyer v. Magnolia Petroleum Co.*, *supra* note 40.

⁷³ *Williams & Meyers*, *supra* note 38. The authors defend the minority rule of *Texas Gulf Producing Co. v. Griffith*, 218 Miss. 109, 65 So. 2d 447 (1953), and criticize the majority rule expressed in *Hunter Co. v. Shell Oil Co.*, 211 La. 893, 31 So. 2d 10 (1947). The *Griffith* case involved pooling by application of equitable pooling doctrines which are peculiar to that state. The court was unwilling to expand that doctrine to hold that pooling achieved by equitable measures affected excluded acreage.

⁷⁴ *E.g.*, *Scott v. Pure Oil Co.*, 194 F.2d 393 (5th Cir. 1952); *Kenoyer v. Magnolia Petroleum Co.*, *supra* note 40; *Hunter Co. v. Shell Oil Co.*, *supra* note 73.

reduce the risk that the lessee will seek to pool only a fraction of the lease with little or no geological justification for his action.⁷⁵

⁷⁵ *Pohlemann v. Stephens Petroleum Co.*, 197 F.2d 134 (10th Cir. 1952); *Nunley v. Shell Oil Co.*, 76 So. 2d 111 (La. Ct. App. 1954). In *Trawick v. Castleberry*, 275 P.2d 292 (Okla. 1954), declaration of a new unit resulted in exclusion of seventy-three of the eighty acres under lease. Cancellation of the lease as to seventy-three acres was denied for lack of evidence that additional development would have been profitable.